

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Mail Processing Network  
Rationalization Service Changes, 2012

Docket No. N2012-1

REPLY BRIEF OF THE PUBLIC REPRESENTATIVE

(July 20, 2012)

Respectfully Submitted,

/s/ Christopher J. Laver

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Docket No. N2012-1

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I.	Postal Service Must Consider Rate Cap Policy Implications .....	3
II.	Record Contains Insufficient Financial Impact Information.....	4
A.	Postal Service Cost Savings Financial Analysis Cannot Be Replicated .....	5
1.	Postal Service Uses the Wrong Benchmark to Measure Cost Savings.....	5
2.	Postal Service Overstates Transportation Cost Savings .....	8
3.	Postal Service Invents Productivity Improvement Estimates.....	9
B.	Estimates of Loss of Revenue are Unreliable .....	10
III.	POSTAL SERVICE OPTIMIZATION EFFORTS FALL SHORT .....	12
A.	Postal Service's Defense of Witness Rosenberg's Efforts is Inapposite .....	12
B.	Postal Service Fails to Prove Elimination of Overnight Delivery is Necessary .....	14
C.	Postal Service Deflection of Modeling Criticism is Inappropriate .....	15
IV.	CONCLUSION .....	15



The Postal Service contends that its request is well supported and rests on a solid foundation.<sup>1</sup> The Postal Service's request, supporting testimony and the record developed in this docket show, however, that crucial questions remain unanswered. As discussed in its initial brief, the Public Representative outlines the questions the Postal Service must, at least internally, answer before moving forward. First, the Postal Service has not considered the policy implications of an increase in real price on two classes of mail, each of which are subject to a rate cap. Second, the Postal Service has not put forward reliable, probative, or substantial evidence concerning either side of the financial equation, including the loss in value to mailers or the financial gain for the Postal Service. Third, the Postal Service does not effectively utilize the modeling tools and decision analysis tools available to it, and inexplicably discounts the contribution of modeling and operations experts that offer constructive feedback.

#### I. Postal Service Must Consider Rate Cap Policy Implications

The Postal Service, in its initial brief, again fails to address the relationship between price and quality. Nonetheless, interveners, including the Public Representative, regard this relationship as vital to the proposed service standard change. The National Association of Letter Carriers (NALC) posits, "[the Postal Service] also refuses to see that its reduction of service standards would constitute a real price increase."<sup>2</sup> The Greeting Card Association (GCA) declares, "a cut in service standards is tantamount to a real increase in price of postal services."<sup>3</sup>

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<sup>1</sup> Initial Brief of United States Postal Service [4:19 PM Errata], July 10, 2012 (Postal Service Brief) at 40-60.

<sup>2</sup> Brief of Intervenor National Association of Letter Carriers, AFL-CIO, July 10, 2012 (NALC Brief) at 18. See *also*, Tr. 3/839.

<sup>3</sup> Initial Brief of the Greeting Card Association, July 10, 2012 (GCA Brief) at 56.



NALC suggests anecdotally that “speed of delivery is an important attribute of the quality of mail service.” NALC Brief at 3. NALC supports this argument by providing an example from Britain’s Royal Mail:

...the existence of a 20% price differential in Britain’s Royal Mail between quicker first-class mail and slower second-class; that certain customers are willing to pay for the higher-priced first-class mail shows that they value speed of delivery.

*Id.* The National Postal Policy Council (NPPC) and Major Mailers Association (MMA) comment that a reduction in service standards equates to a relaxation of the price cap.<sup>4</sup> NPPC and MMA explain that service standards are in place to protect mailers from an erosion of service quality, and that the Postal Service’s proposal is just such an erosion. *Id.* The Public Representative agrees with NPPC and MMA’s conclusion that the “Commission should consider whether the service quality erosion should be offset by a corresponding reduction in the applicable rate cap.” *Id.*

The centerpiece of the 2006 postal reform legislation is the class-based rate cap that protects mailers of each class of mail from increases in postal rates that outpace inflation. That rate cap is meaningless if the Postal Service is able to set class-based service standards at will. At an absolute minimum, the Postal Service must explain how its proposal is consistent with the statutory aims of protecting users of each class of mail. However, in the testimony of thirteen witnesses, responses to interrogatories from the Public Representative, and a brief discussing relevant issues to the case, the Postal Service fails to mention the relationship between the class-based rate cap and its proposal to adjust service for two classes of mail.

## II. Record Contains Insufficient Financial Impact Information

As the Public Representative discusses in its initial brief, analyzing the Postal Service’s proposal quantitatively involves balancing the projected cost savings for the Postal

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<sup>4</sup> Comments of the National Postal Policy Council and the Major Mailers Association, July 10, 2012 at 7.



Service against the loss in value to the mailers. In this case, neither side of the financial equation is supported by substantial evidence.

#### A. Postal Service Cost Savings Financial Analysis Cannot Be Replicated

There are three reasons the Postal Service's calculation of savings cannot be replicated and is not supported by substantial evidence in the record. First, the Postal Service uses the current network (with FY 2010 data) as the benchmark. To have an accurate picture, the Postal Service should have used the current *optimized* network as a basis for its cost savings. Savings that may be realized without a change in service should not be attributed to a proposal that requires a change in service. Second, the Postal Service's transportation savings are overstated due to problems with the estimation of plant-to-plant and plant-to-post office cost savings estimates. Third, the Postal Service's productivity estimates are not reliable and are overstated as witness Neri provides no rational, quantitative, or reasonable explanation for his estimates.

##### 1. Postal Service Uses the Wrong Benchmark to Measure Cost Savings

The Commission has accepted the principle that the benchmark costs against which a change of service proposal should be evaluated are those found in the most recent Annual Compliance Determination (ACD).<sup>5</sup> The Commission also did not reject the "Full-Up Method" to determine the cost savings attributed to the proposed change in service. Full-Up costs include volume variable costs as well as case-specific measurement of indirect and piggybacked costs that differ from Commission-approved costing methods used in the Annual Compliance Review (ACR). The Commission determined that it would review the Postal Service's Full-Up Method for each component of the proposal and accept it where it improved the estimates of the cost component under consideration. *Id.* at 32.

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<sup>5</sup> See, e.g. Docket No. N2010-1, Advisory Opinion on Elimination of Saturday Delivery ("Six to Five Day Opinion") at 31, filed March 24, 2011.



The Postal Service request, filed in December of 2011, should be based on FY 2010 ACD costs. The benchmark should be the optimized cost of mail processing and transportation constrained by FY 2010 operations and service standards. The cost of the proposed change in service standards would be equal to the optimized cost of mail processing and transportation operations constrained by FY 2010 and the proposed service standards. By factoring out savings due to the consolidation of plants under existing service standards, the difference between the proposed network and the network optimized under current service standards would be equal to the savings that resulted from implementing the proposed service standards.

The time period, network, and service standards from which to determine both benchmark costs and cost savings are not clear in the record before the Commission. The Postal Service provides the estimated cost savings from AMP consolidations and any Post Implementation Reviews. Tr. 2/316. AMP savings are based on savings from both plant consolidation and elimination of overnight delivery. Tr. 9/2767. Similarly AMP savings are not determined in comparison to the universe of plants optimized under current service standards. Tr. 4/1370. Moreover, AMP studies are not performed on all of the plants which Logic Net and Local Insight determined would be combined. Sums of AMP savings do not isolate the effect of savings due only to the change in service standards, and are incomplete.

The Postal Service's modification of the implementation date of the proposal (splitting it into phases) causes further difficulty. In the interim phase, which would retain an "overnight service standard for all intra-Sectional Center Facility (SCF) First-Class Mail, regardless of the point of entry or level of preparation...."<sup>6</sup>, 140 plants will be closed. The Postal Service estimates \$1.2 billion in cost savings for the interim phase. Ninety more plants will be closed in the final phase, bringing an additional savings of \$1.37 billion. Tr. 9/2716-2718. This proposal may lead one to conclude that the interim network is the FY 2010 network optimized

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<sup>6</sup> See, Federal Register, Vol. 77, No. 102, Friday, May 25, 2012, at 31190.



under current service standards. However, the interim network only retains overnight service for intra-SCF mail. The number of plants chosen for the interim phase is not based on an optimization of the network under the standards proposed for the interim stage. Furthermore, the savings from implementing the interim network are not based on the difference in cost from the network optimized under the service constraint of the interim network minus the optimized network under current service standards. Cost savings are simply the original total savings estimate of \$2.57 billion multiplied by the ratio of the square footage of the plants closed in the interim network to the square footage of the plants closed in the original proposal. *Id.* at 2717. Finally, the cost of the interim network does not include lost revenue. *Id.* at 2718.

The savings from the interim network are the difference between 1) a reduced, but non-optimized, network with limited overnight delivery; and 2) a non-optimized FY 2010 network with overnight delivery. Consequently, the cost differences between the current network and the interim network do not properly measure cost savings attributable to the change in service standards proposed for the interim network.

In summary, the Public Representative maintains that the appropriate baseline is the FY 2010 mail processing network that is optimized under FY 2010 service standards. The financial analysis of whether the service change is necessary should only balance those costs that can be saved *only* through a reduction in service standards against the loss in revenue attributed to that reduction in service.<sup>7</sup>

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<sup>7</sup> The Postal Service's proposal lacks consistency in this instance. For the reduction in volume/revenue, the Postal Service uses two probability factors to ensure that any change in volume reported by the mailer surveyed is **solely** attributable to the change in service standards under consideration. Likewise, the Postal Service must exercise the same caution on the other side of the equation, that any reduction in cost is **solely** attributable to the service change.



## 2. Postal Service Overstates Transportation Cost Savings

The Public Representative, as well as other parties, extensively discuss the issues surrounding the estimation of transportation cost savings.<sup>8</sup> Two other issues relating to the overstatement of transportation cost savings, however, are relevant.

Hubs form an essential part of the proposed network, but are not considered in the cost savings estimates. Postal Service witness Williams confirms “for efficient transportation we would need to establish hubs....” Tr. 2/270. Witness Martin, in her analysis of transportation costs, does not include hubs in her initial analysis of the transportation network or in her supplemental testimony that updated after AMP study results were released. See Tr. 4/1210, Tr. 8/2570. As a result, witness Bradley’s cost estimates do not include analysis of hubs. Tr. 5/1807-1808. The Public Representative agrees with APWU and NPMHU that the Postal Service should have included analysis on hubs in the record. See APWU Brief at 11, NPMHU Brief at 26, 31.

Similar to the discussion surrounding the use of the proper benchmark to measure cost savings in the mail processing network, the Postal Service also includes savings for converting transportation from Postal Service employees (PVS) to highway contract (HCR). The savings the Postal Service derives from such a conversion is not attributable to the consolidation plan. Witness Martin confirms that a change from PVS to HCR “is something that managers can take and initiative...regardless of network consolidation...” The Public Representative agrees with the NPMHU that such cost savings should not be considered a result of the Postal Service’s proposal. NPMHU Brief at 13.

These problems, coupled with those discussed earlier in the initial brief, lead the Public Representative to agree with APWU that witness Bradley’s estimate of cost savings is

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<sup>8</sup> See Initial Brief of the Public Representative, July 10, 2012 at 28-33, *see also* Initial Brief of the American Postal Workers Union, AFL-CIO, July 10, 2012 (APWU Brief) at 16, Brief of the National Postal Mail Handlers Union, July 11, 2012 (NPMHU Brief) at 10-12.



reduced to a theoretical model that depends on rough estimates of changes presented by other witnesses, such as witness Martin. See APWU Brief at 12.

### 3. Postal Service Invents Productivity Improvement Estimates

The majority of savings from the MPNR stem from productivity improvement estimates witness Neri fabricates and provides to witness Bradley. Many parties agree that witness Neri's method is fundamentally flawed.<sup>9</sup>

The Postal Service challenges witness Weed's conclusion that witness Neri overstated excess capacity: "witness Weed simply ignores the significant disparities between volumes and work hours in his own Figure 1." Postal Service Brief at 105. However, if one divides the data used by witness Weed into the three tours used by witness Neri: Tour 1: 22:00-5:00; Tour 2: 6:00-13:00, Tour 3: 14:00-21:00, the percentage point difference between the percent of volume in each hour of the day, and the percent of hours employed each hour of the day, (excess capacity) is substantially below the 27 percent difference estimated by witness Neri.

Table 1 below shows the maximum and minimum percentage point difference between volume and hours on each tour. The maximum difference between maximum and minimum difference on each tour would be the amount of excess capacity per tour.

Table 1  
Maximum and Minimum Percentage Point Differences  
Between Hours and Volumes by Tour

	Maximum Difference	Minimum Difference	Excess Capacity
Tour 1	1.3%	-3.7%	5.0%
Tour 2	2.4%	-0.2%	2.6%
Tour 3	0.9%	0.1%	0.7%

Source: rev\_PRCWIT-LR-1 Savings (Pub Ver.).xlsx, Sheet: "Auto Ltr", cells L7:L30.

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<sup>9</sup> See APWU Brief at 17, NPMHU Brief at 6, Initial Brief of the National Newspaper Association, July 10, 2012 (NNA Brief) at 9, and Tr. 11/4196.



The Public Representative calculates a maximum level of excess capacity of 5 percent, yet the Postal Service calls this amount a “significant disparity” (from full capacity). *Id.* The Public Representative disagrees with this conclusion. The maximum excess capacity estimated by witness Weed is 5 percent and the median is 2.6 percent. Far from confirming a “large gap by which volumes exceed workhours,” as maintained by the Postal Service, the data supplied by witness Weed suggests there is much less excess capacity from which productivity improvements may be extracted than maintained by witness Neri. *Id.* These data also support the conclusion that the Postal Service’s plan will cause mail to backup, as maintained by NPMHU, NNA, and the Public Representative. See, e.g., Tr. 4/3727, Tr. 10/3049-51, 3122, 3131-32, 3353 and Tr. 11/3706.

#### B. Estimates of Loss of Revenue are Unreliable

The Postal Service contends that it has “presented reliable and valid market research and examined customer response to the proposed changes....” Postal Service Brief at 75. It mentions that the market research has been produced at tremendous cost by world class experts using the best available research designs. *Id.* at 92.

The Postal Service actually commissioned the market research twice. It used the same “world class” expert twice (and paid for the research twice). The aims of the research were identical. The methodologies were identical, save the addition of a second probability factor (unsupported in literature or practice) to skew the results toward finding no change in volume. Tr. 12/4437.

The Postal Service states that the results of the second research prove that the broad concept statement biased the initial results since the results were different. Postal Service Brief at 81. The simple truth is the Postal Service uses outcome-based research, and adjusts the methodology and content of the survey to achieve a result that allows it to move forward with its proposal, without an attempt to provide sound analysis.

NALC concludes that the data from the abandoned all-causes research yields preliminary results showing that multiple Postal Service cost-cutting initiatives would, in fact,



produce a precipitous decline in mail volume of over ten percent. NALC Brief at 2-3. APWU echoes these concerns stating, “those results indicated that the MPNR would have a “massive, massive impact on the business.” APWU Brief at 30; Tr 3/866. The abandonment of these preliminary research figures showed APWU that “the Postal Service placed itself in the position of proceeding without completing the only research they had begun that would have confirmed the cumulative effects of ongoing Postal Service initiatives.” APWU Brief at 33; Tr. 3/868-869.

The Public Representative is concerned that the second phase research has been corrected using a downward bias. APWU shares the same concern concluding, “ORC’s [Opinion Research Corporation’s] research has systematically been biased downward.” APWU Brief at 34. Moreover, APWU and GCA acknowledge that the marketing research could have been done in a different way, but it is unrealistic for the Postal Service to assume that the results from the Phase II research will be duplicated in the real world. *Id.* at 35,<sup>10</sup> GCA Brief at 19.<sup>11</sup>

The market research suffers from other serious flaws, as discussed in the initial brief. The Public Representative shares NALC’s concern that the confidence intervals provided for the research cannot be replicated or verified. NALC Brief at 6. The Public Representative also agrees with NALC and GCA that the volume runoff may be significantly underestimated, because the Postal Service has not attempted to quantify any effects that may take place after the 12 month forecast period. *Id.* at 2, GCA Brief at 15.

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<sup>10</sup> APWU – Phase 2 was carefully controlled to require respondents to focus just on First Class Mail service standard changes. The world is not so controlled; and publicity about the proposed elimination of Saturday delivery and about post office closings ensures that the laboratory conditions that produced the Phase 2 results will not exist in the real world.

<sup>11</sup> GCA – Acknowledging that both the all-sources and the narrow-focus investigations could have (different kinds of) practical value, we nevertheless submit that for the Commission’s purposes the cumulative effects revealed by the broader inquiry must be taken into account.



### III. POSTAL SERVICE OPTIMIZATION EFFORTS FALL SHORT

#### A. Postal Service's Defense of Witness Rosenberg's Efforts is Inapposite

Witness Rosenberg is the Postal Service's primary network optimization witness. The Postal Service devotes four pages of its brief recounting witness Rosenberg's testimony. Postal Service Brief at 41-45. Witness Rosenberg's optimization efforts are substantially undermined by witnesses Rhagavan and Kacha. These witnesses provide alternate modeling outcomes that substantially undermined the premise of the Postal Service's proposal, namely that the elimination of overnight delivery is a necessary condition for bringing labor hours into alignment with mail volume, thereby producing substantial productivity improvements and cost savings.

"The underlying realignment of mail processing operations is based on changes in the overnight service standards for First-Class Mail and Periodicals. When fully implemented, these service changes will permit a large reduction in requisite network capacity and associated mail processing costs."

*Id.* at 29.

Witness Rhagavan's testimony provides a litany of problems with the methods with which witness Rosenberg utilizes Logic Net, the Scoring Tool and Detailed Equipment Modeling. The Public Representative will not repeat them here. Of most significance is his finding that by running witness Rosenberg's Logic Net model, and adopting all of her assumptions except the elimination of overnight delivery, the model predicts an optimized network would only need between 239 and 277 plants, rather than 476 MODS plants initially under consideration in this case. Comparing witness Rhagavan's Logic Net results to Rosenberg's shows that eliminating overnight delivery to permit operating windows to be extended, only reduces the required number plants between 40 and 78. Tr. 10/3146.

While the amount of cost savings that would occur if the Postal Service were to optimize its mail processing network and retain current service standards was not produced, witness Rhagavan's finding seriously undermines the basis upon which the Postal Service's Proposal rests, namely substantial cost savings can only be achieved if overnight delivery is



eliminated. Many parties recognized the significance of this finding. See, GCA Brief at 7, Valpak Brief at 18. APWU similarly concludes that current service standards could be maintained by reducing the number of MODS plants from 476 plants to 350 plants. APWU Brief at 38.

Rather than address witness Rhagavan's use of Logic Net dealt to the foundational premise of its case, the Postal Service chooses to criticize his language.<sup>12</sup> See Postal Service Brief at 95. The Postal Service concludes that a Section 3661 review does not require it to use ideal methods or propose the best changes. *Id.* 96. This argument misses the important point that while the Postal Service may choose to justify its proposal in terms of Section 3661, so is the Commission entitled to advise the Postal Service of the flaws and risks posed by the quantitative justifications it has offered in defense of its proposal to reduce service standards. In the end, witness Rhagavan is clear that in this case, where a major change is being contemplated, it is very important to validate every aspect of the modeling efforts undertaken.

"I think there is consensus that ...at some level you have to feel comfortable with the extent to which you model the problem, and once you get the results you have you need to make sure to validate them. And in this particular case ... there were no follow-up simulation studies that were done to see whether the ... proposed mail sorting network ... had enough capacity...."

"[i]t also depends on how significant change there is ... and so I would say that if the change is a complete change, then certainly you want to be sure ... that it's right because there may be no chance to ... roll it back."

Tr. 10/3180-3182.

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<sup>12</sup> "It would have been ideal if instead of solely focusing on the cost savings associated with the proposed service standard, the Postal Service had also conducted a similar network optimization analysis on the current network identifying opportunities to change mail processing windows, optimize their network by shutting down mail processing facilities, generating efficiencies in transportation, and by smoothing the workload to the extent possible within the current service standard." Tr. 10/3134.



## B. Postal Service Fails to Prove Elimination of Overnight Delivery is Necessary

The Postal Service contends that the service standard change proposed in this docket “would allow for a significant consolidation of the Postal Service’s processing and transportation networks.” Postal Service Brief at 3. The Postal Service avers that such a change would also “create an opportunity to capture considerable cost savings.” *Id.* at 27.

In reality, the Postal Service’s proposal assumes that a change in service standards is a necessary step in optimizing its network, and that substantial cost savings cannot be captured without change of service standards. The Postal Service believes that consolidations are only possible if the service standard changes are implemented. *Id.* at 21, 41. The Public Representative, however, agrees with other parties that the consolidation/optimization plan should be distinguished from the plan to degrade service.<sup>13</sup>

Multiple parties recognize the trend of mail volume decline and agree that consolidation of mail processing network and elimination of some facilities is reasonable or even required. GCA Brief at 1, Valpak Brief at 14, 16-18. The Public Representative agrees with GCA that “the simulation work leading to the actual rationalized network design was inherently biased”. GCA Brief at 23. Modeling efforts would have been more robust had they been utilized to determine the extent to which consolidation was feasible without the elimination of the overnight service standard. Multiple parties refer to the comprehensive analysis performed by Public Representative witness Raghavan demonstrating that consolidation is possible under current service standards, as discussed in the previous section.<sup>14</sup>

Parties agree that it is possible to achieve cost savings if consolidation is made under current service standards. GCA Brief at 5; NNA Brief at 13; APWU Brief at 39; Valpak Brief at 16-17. GCA provides estimates of savings under current service standards based on

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<sup>13</sup> See, e.g. GCA Brief at 2, Initial Brief of Valpak Direct Marketing Systems, Inc., and Valpak Dealers’ Association, Inc., July 10, 2012 (Valpak Brief) at 15.

<sup>14</sup> GCA Brief at 6-7, 41, 48; NNA Brief at 13; Valpak Brief at 18.



Public Representative witness Raghavan reduction of plants, costs estimates by witness Bradley and gross revenue savings estimated by witness Whiteman. GCA Brief at 7-8. The Public Representative agrees that it is possible to obtain cost savings as a result of consolidations made under current service standards, although the amount of savings might be different from those estimated by GCA.

#### C. Postal Service Deflection of Modeling Criticism is Inappropriate

The Postal Service characterizes witness Rosenberg's use of the Excel Scoring Tool and optimization modeling as "decision support tools" and only a "modeling exercise." Postal Service Brief at 41. The Postal Service emphasizes that modeling results were shared with area managers, and then assessed and adjusted by those managers. *Id.* at 25. The Postal Service repeatedly insists that the modeling efforts were only a starting point for discussion.

The Public Representative takes issue with such characterization. If a tool is not accurate or cannot be validated, it does not have value even as a "starting point for discussion." If management expertise, which could be incorporated into a model, is the basis for every decision, the modeling effort is simply a waste of time and money.

#### IV. CONCLUSION

The Public Representative finds that there are serious shortcomings and questions the Postal Service must address before moving forward with its proposal. Taken as a whole, the Postal Service's proposal is a feasible, rational response to falling demand and revenue shortfalls. However, the Postal Service should allow for transparent review of a proposal that will affect every user of the mail. Robust, data-driven analysis, as opposed to "best guess" or "results-driven" analysis, should form the basis for a change of such magnitude. The Public Representative believes the Postal Service could learn from numerous experts attempting to help refine and polish its proposal, as opposed to dismissing any ideas or criticism from outside the organization as carrying "little or no weight."

As discussed above, the Postal Service need view its proposal to increase the real price of two classes of mail in light of the statutory framework, especially the class-based rate



cap requirement. The Postal Service should ensure that it has a more accurate view of the financial equation, measuring both loss of value to mailers and cost savings, than presented in this docket. Finally, the Postal Service should attempt to use quantitative modeling and decision analysis tools in a manner that reflects best business practices, and allows for greater consistency and robust application. The Public Representative respectfully request that the Commission encourage the Postal Service to move forward with its proposal, but only after it, at least internally, answers the above shortcomings presented in its case.